

VZCZCXR08530
RR RUEHBI RUEHCI RUEHCN RUEHGHH
DE RUEHGHH #0785/01 3450905
ZNR UUUUU ZZH
R 110905Z DEC 07
FM AMCONSUL SHANGHAI
TO RUEHC/SECSTATE WASHDC 6521
INFO RUEHBJ/AMEMBASSY BEIJING 1572
RUEHCN/AMCONSUL CHENGDU 0995
RUEHGZ/AMCONSUL GUANGZHOU 0965
RUEHSH/AMCONSUL SHENYANG 0995
RUEHIN/AIT TAIPEI 0814
RUEHHK/AMCONSUL HONG KONG 1123
RUEHNE/AMEMBASSY NEW DELHI 0019
RUEHCG/AMCONSUL CHENNAI 0007
RUEHCI/AMCONSUL KOLKATA 0003
RUEHBI/AMCONSUL MUMBAI 0003
RUEHIL/AMEMBASSY ISLAMABAD 0012
RUEHUL/AMEMBASSY SEOUL 0151
RUEHGP/AMEMBASSY SINGAPORE 0104
RUEHKO/AMEMBASSY TOKYO 0240
RUCPDOC/DEPT OF COMMERCE WASHINGTON DC
RHEHAAA/NSC WASHINGTON DC
RUEHGH/AMCONSUL SHANGHAI 7040

UNCLAS SECTION 01 OF 04 SHANGHAI 000785

SIPDIS

SENSITIVE
SIPDIS

STATE PASS USTR FOR STRATFORD/WINELAND/KATZ/WINTER
USDOC FOR 4420
USDOC FOR ITA/MAC DAS KASOFF/MELCHER/MCQUEEN/SZYMANSKI
NSC FOR SHRIER AND TONG

E.O. 12958: N/A

TAGS: [ETRD](#) [EFIN](#) [EINV](#) [ELAB](#) [PGOV](#) [PREL](#) [CH](#) [IN](#)
SUBJECT: LEADING INDIAN IT COMPANIES BULLISH ON CHINA MARKET

(U) Sensitive but unclassified. Not for dissemination outside USG channels or posting on the internet. Please protect accordingly.

11. (SBU) Summary: Poloff met with high level managers of three Indian information technology (IT) companies operating in Shanghai -- Tata Consultancy Services, Infosys Technologies, Satyam Computer Services -- to discuss their current operations and future outlook for the China market. They explained that their companies established operations in China in order to: 1) Tap China's huge domestic market; 2) Service multinational corporations operating in China; and, 3) Gain access to the Japan and Korea markets. They also detailed reasons for choosing specific cities within China, including cost considerations, infrastructure, and availability of local talent. Although they expressed concerns about rising labor costs and problems with retention, they were upbeat about the current business climate and generally bullish about growth prospects for the near future.

Overview of Business in China

12. (SBU) Poloff spoke with the head managers of three Indian IT firms in Shanghai: Tata Consultancy Services (TCS), Infosys Technologies, and Satyam Computer Services. All three companies provide IT software solutions, IT consulting services, and business process outsourcing (BPO) services to Western, Japanese, Korean, and some domestic Chinese firms in China. According to Anantha Murthy, General Manager of TCS in Shanghai, a division of the Tata Group, TCS began its operations in China in 2002. Its offices in Shanghai and Hangzhou service Western (mostly U.S.) firms, such as Motorola, Bloomberg, GE, Johnson Controls, and Eaton while its Beijing office mainly provides IT banking solutions to its largest domestic client, the Bank of China. (Note: Murthy is an Indian national living in Shanghai 5

years. He stated that he established TCS' offices in Shanghai and Hangzhou in 2002 and is currently the head manager of these offices. End note.) According to James Lin, CEO and Managing Director of Infosys Technologies China, Infosys set up its first subsidiary in China in 2003 and began operations in 2004. Like TCS, Infosys has offices in Shanghai, Hangzhou, and Beijing. Its Shanghai and Hangzhou offices cater to Western multinationals while its Beijing office mainly engages in marketing and government relations. (Note: Lin is a Chinese-American fluent in both English and Chinese. He stated that he established Infosys' offices in Shanghai and Hangzhou four years ago and is currently responsible for all operations in China. End note.) Raghvendra Tripathi, Head of Greater China, Satyam Computer Services (Shanghai) Co., stated that his company set up its first China office in Shanghai in 2002. Currently, Satyam has offices in five locations throughout China: Shanghai (head office), Nanjing, Dalian, Guangzhou, and Beijing. Its clients include mostly Western multinationals operating in China as well as Japanese and Korean firms but very few Chinese domestic firms. (Note: Tripathi is an Indian national living in Shanghai five years. He stated that he established Satyam's office in Shanghai in 2002 and is currently responsible for all operations in China. End note.)

Why China? Why Shanghai?

¶3. (SBU) All three companies cited similar reasons for their companies' entry into China: 1) Tap China's huge domestic market; 2) Service multinational corporations operating in China; and 3) Gain access to Japan and Korea, two large potential markets for BPO services. All three companies currently have few Chinese domestic clients, but Murthy of TCS and Lin of Infosys see potential in certain sectors, such as banking, since Chinese banks have recently begun upgrading their

SHANGHAI 00000785 002 OF 004

IT infrastructure to become more internationally competitive. The main line of business for the three companies in China, however, remains IT services, offshore support and back-office support for Western multinationals, many of whom have significant operations in China, especially in the Shanghai area. Although all three mostly have English-speaking local employees, they also have a significant number of Japanese and Korean speaking Chinese employees who provide offshore support to clients in Japan and Korea. Murthy noted how linguistic and cultural differences make it difficult to provide such services to Japanese and Korean clients from India. He explained that geographical proximity, linguistic and cultural ties, and a large pool of Japanese and Korean speakers make China an ideal foothold for entry into the Japan and Korea markets.

¶4. (SBU) Both TCS and Infosys set up one of their first China offices in Hangzhou, a city located 115 miles southwest of Shanghai. When asked why they chose Hangzhou, Lin of Infosys simply stated "the Chinese Government selected the location. The government wants foreign firms to invest in certain places."

(Note: Hangzhou is the capital of Zhejiang Province just south of Shanghai. Hangzhou is not only a major tourist destination renowned for its natural beauty, it is also a prosperous business and industrial center with high per capita GDP and one of the best universities in eastern China -- Zhejiang University. End note.) Lin also mentioned that personnel costs in Hangzhou are lower than in Shanghai, and due to their physical proximity, the Hangzhou office is manageable from Shanghai. However, both Lin and Murthy of TCS stated that Hangzhou is probably "not the right place" to further expand their operations, mainly due to its relatively limited pool of local talent. Murthy explained that although Shanghai is more expensive in terms of personnel costs, its larger pool of talent (i.e. young professionals and new graduates who are highly educated and fluent in English, Japanese, or Korean) and superb infrastructure make up for the higher costs.

¶5. (SBU) Unlike TCS and Infosys, Satyam did not set up an office in Hangzhou because, according to Tripathi, the city was already

"saturated" by its competitors (i.e. TCS and Infosys). He agreed with Murthy and Lin that Shanghai offers the largest pool of talent, and Satyam has maintained its largest office in Shanghai. But he revealed that higher costs in Shanghai led his company to seek expansion in other cities with lower costs and relatively untapped resources. When deciding on a location for Satyam's new service center last year, Tripathi said he surveyed five locations: Tianjin, Xian, Nanjing, Guangzhou, and Chengdu. The finalists were Chengdu and Nanjing due to overall cost and availability of local talent, but he finally decided on Nanjing because overseas customers would be able to access it more easily.

¶ 16. (SBU) All three companies revealed that local government entities aggressively approached (and still approach) them to invest in their cities. Murthy and Tripathi feel that local governments act largely independent of the Central Government in pursuing investors. Murthy mentioned how the local government of Hangzhou even bestowed Tata Chairman Ratan Tata the title of Honorary Economic Advisor to Hangzhou. Murthy further stated that he receives "several visitors" every week from various cities and provinces seeking investment from TCS. (Comment: These three Indian companies are not alone in this regard. As central authorities seek to cool foreign direct investment, local governments continue to ply U.S., Taiwanese, Korean and many other foreign companies with incentives to win their investment dollars. End comment.)

Non-Linear Growth of IT Sector

¶ 17. (SBU) Murthy of TCS said his company experienced "gradual

SHANGHAI 00000785 003 OF 004

linear expansion" from 2002 to 2005, with the total number of employees reaching 300 by 2005. However, after signing large deals with the Bank of China and other multinationals in 2005, TCS China entered a phase of accelerated "non-linear growth," expanding to 1200 employees in 2007. Murthy expects this pace of growth to continue, with his company expanding to 1700 employees by March 2008, 3500 by March 2009, and 5000-6000 by 2010 to become the largest IT company by revenue in China. According to Murthy, TCS worldwide has had 40 percent growth in revenue year on year, but annual growth in the Asia Pacific region has been 66 percent, and he expects 100 percent annual growth during the next three years in China. Although its operations are centered in Shanghai, Hangzhou, and Beijing, Murthy said that TCS recently opened another office in Tianjin, which will commence operations in the near future.

¶ 18. (SBU) Lin of Infosys was similarly bullish regarding growth prospects for his company in China. Although his company's China operations have grown exponentially from 40 employees in 2004 to about 750 now, Lin believes this increase has been "too slow" and looks towards accelerated growth in the near future. He revealed that Infosys is currently looking to set up offices in other areas, such as Nanjing and Suzhou, where personnel costs are lower and he feels there is still room for expansion. Although Tripathi of Satyam also claimed to be "reasonably bullish" about his company's growth prospects in China, he actually sounded less optimistic than the others, revealing that his company's total investment in China was beginning to "taper off." (Note: Tripathi was not clear about the total amount of his company's investment in China, though he estimated it to be about USD5 million. End note.) He said that his company plans to expand from its current 700 employees in China to about 2000 in 2010, with the majority being relocated to their new service center in Nanjing, which commenced operations this February. However, Tripathi did not envision his company setting up any new offices in the near future, stating that it was now "time to consolidate" its current operations.

Possible Constraints on Growth

¶ 19. (SBU) The three companies Poloff spoke with characterized the

Chinese business environment as "very good" and were generally optimistic about future growth. None expressed concerns about Chinese regulatory hurdles or red tape. However, they commonly mentioned rising personnel costs and difficulty in retaining talent as possible constraints on future growth. Murthy cited figures showing Chinese employees cost 20-30 percent more than their Indian counterparts. Lin attributed much of this added cost to benefits, such as retirement pensions and health insurance, and believes this cost is rising and will continue to rise because of new labor regulations. According to Lin, hiring talented employees is not a problem, but retaining them is very difficult. He said that Infosys' annual attrition rate is about 25 percent, the "industry average" according to him. Murthy stated that his company's annual attrition rate has been about 15-18 percent, lower than the average, and that he has been "very lucky" in this regard. Tripathi agreed that retention has been difficult but was careful to differentiate between the "highly skilled" (i.e. Oracle, SAP, and other advanced software experts) and "lower skilled" (i.e. general computer programmers), stating that the "highly skilled" have been particularly difficult to retain.

Chinese Competition: Changing the Local Mindset

¶10. (SBU) Tripathi also mentioned difficulties inculcating a "service mindset" in local employees, saying this has been the most time-consuming part of training new employees since Chinese workers have little experience in services and still embrace the

SHANGHAI 00000785 004 OF 004

"mindset of manufacturing industries." Related to this, Lin pointed out that this is one of the reasons why his firm does not feel threatened by the increasing number of Chinese competitors. According to Lin, although the Chinese are "good at learning and copying," it will take a while for them to become competitive in services since "this industry involves people, not just simple manufacturing." Murthy estimates that about 20 Chinese delegations visit India every month to learn about the outsourcing industry, and China has a strong interest in developing this sector as exemplified by the establishment of software parks in Nanjing, Tianjin, and Wuxi. However, like Lin and Tripathi, he believes TCS is well ahead of the game, and it will take Chinese competitors years to even get into the game.

Comment

¶11. (SBU) Like the majority of foreign businesses we have talked to in Shanghai, all three Indian IT firms were optimistic about their companies' current and future business prospects in China. They also reflected concerns similar to other foreign enterprises seeking to grow their operations in China. Retaining experienced employees remains among the top issues along with general unease over changing labor regulations and rising labor costs. (Note: Shanghai AmCham surveys have cited these among the top business issues for U.S. companies in the Shanghai area over the past several years. End note.) Many, like Infosys, are bullish to expand but remain frustrated that rising personnel costs and retention problems are inhibiting more accelerated growth. Like thousands of other foreign companies in China, these Indian IT firms face the challenge of finding areas with low cost, sufficient infrastructure and local talent as they expand further inland.

JARRETT